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MULTILATERAL INVESTMENT FUND

PERU

**SUPPORT FOR CAPITAL MARKET DEVELOPMENT IN PERU WITH
AN EMPHASIS ON VENTURE CAPITAL (“INVEST PROGRAM”)**

(TC-02-07-01-4)

DONORS MEMORANDUM

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Annex I Logical framework

ABBREVIATIONS

AFPs	Administradoras de Fondos de Pensiones (privados) [Private Pension Fund Administrators]
BVL	Bolsa de Valores de Lima [Lima Stock Exchange]
CONASEV	Comisión Nacional Supervisora de Empresas y Valores [National Securities Commission]
FINEP	Financiadora de Estudios e Proyectos
GDP	Gross domestic product
INDECOPI	Instituto de Defensa de la Competencia y la Propiedad Intelectual [Fair Trade and Industrial Property Office]
MEF	Ministry of the Economy and Finance
MIF	Multilateral Investment Fund
ONP	Oficina Nacional Previsional [National Pension Office]
PROCAPITALES	Asociación de Empresas Promotoras del Mercado de Capitales [Business Association for Capital Market Development]
PROINVERSION	Agencia para la Promoción de la Inversión [Investment Development Agency]
PROMPYME	Comisión de Promoción de la Pequeña y Microempresa [Commission for the Promotion of Microenterprise and Small Business]
SBS	Superintendencia de Banca y Seguros [Superintendency of Banking and Insurance]
SME	Small and medium-sized enterprise
UPC	Universidad Peruana de Ciencias Aplicadas [Peruvian University of Applied Sciences]

SUPPORT FOR CAPITAL MARKET DEVELOPMENT IN PERU WITH AN EMPHASIS ON VENTURE CAPITAL (“INVEST PROGRAM”)

(TC-02-07-01-4-PE)

EXECUTIVE SUMMARY

Executing agency:	Asociación de Empresas Promotoras del Mercado de Capitales [Business Association for Capital Market Development] (PROCAPITALES).
Beneficiaries:	The beneficiaries of this project will be: (1) enterprises that are members of PROCAPITALES and, in general, participants in the market environment that may benefit by having a channel for their concerns, which will be the project’s regulatory unit; (2) small and medium-sized companies that will receive individualized training and advisory services; (3) venture capital fund administrators and angel investors, who will benefit from a more streamlined and expeditious system to attract funds and make investments; and (4) institutional investors and other qualified investors who, by participating in the venture capital forums, will learn better ways to evaluate and oversee their investments.
Objectives:	The project objective is to help promote an enabling regulatory framework for the capital market and expansion and enhancement of the financing opportunities for small and medium-sized enterprises (SMEs). Capital market development in emerging markets covers a wide range of activities, including the institutional development and strengthening, implementation of new financing instruments and mechanisms, and development and improvement of the legal and regulatory frameworks. The project will address these areas, with the goal of developing venture capital.
Description:	The “Invest Program” (<i>Programa Invertir</i>) to support capital market development, with an emphasis on venture capital, will execute its activities under three components, as follows: (i) support for an enabling regulatory and legal framework for capital market development; (ii) customized training and advisory services for SMEs to enable them to access financing on more favorable terms and, in particular, to obtain direct investments through diversification of capital ownership; and (iii) strengthening of venture capital fund administration capacity in Peru.

Financing:	Modality:	Nonreimbursable - Facility I
	MIF:	US\$1,145,500
	Local counterpart funding:	US\$ <u>836,300</u>
	Total:	US\$1,981,800
Execution timetable:	Execution period:	36 months
	Disbursement period:	42 months
Exceptions to Bank policies and procedures:	None.	
Special contractual conditions:	Prior to the first disbursement, the executing institution will submit evidence, to the Bank's satisfaction, that the coordinating unit has been set up and is operating.	
Social and environmental impact and proposed measures:	The project was reviewed by the Committee on Environment and Social Impact (CESI) at its meeting on 31 January 2003. Its recommendations have been incorporated into paragraph 4.13.	

I. COUNTRY AND PROJECT ELIGIBILITY

- 1.1 At its 14 December 1993 meeting, the Donors Committee declared the Republic of Peru eligible for all types of financing from the Multilateral Investment Fund (MIF). The proposed project is consistent with the general objectives of the MIF, since capital market development is one of the MIF's core areas of interest, as well as increasing the competitiveness of the SMEs by helping them access sources of financing on more favorable terms, with an emphasis on venture capital as a source of financing and long-term capitalization.

II. BACKGROUND FACTS

- 2.1 SMEs¹ in Peru account for 42% of gross domestic product (GDP) and employ 76% of the economically active population. They have grown in an environment that has not necessarily been enabling.
- 2.2 The Peruvian capital market is in its early stages. Judging by the evolution of the Lima Stock Exchange (BVL), Peruvian enterprises, in general, have experienced a setback in their ability to generate wealth within the framework of diffuse stock ownership structures. Market capitalization, which totaled US\$17,383,000,000 in 1997, had receded in 2002 to US\$12,593,000,000. In fact, between 1991 and 2002, Peru had only three initial public offerings, with a total in the aggregate of less than US\$40 billion. The fixed income market evolved with fewer constraints: the private sector bond inventory rose from US\$1,804,000,000 in 1998 to US\$2,358,000,000 at the end of 2002, despite the recessionary environment marking that period. Notwithstanding, the number of issuers was limited to the largest companies, it being practically impossible for medium-size enterprises, let alone small enterprises, to obtain capital.
- 2.3 Capital market development in an emerging country such as Peru requires a series of measures at both the regulatory and direct promotion levels. At the regulatory level, the Legislative Branch and the regulatory agency CONASEV need to obtain information and establish initiatives to help close the gap between the supply of and the demand for equity funds. On the fund supply side, legal restrictions and tax aspects should be analyzed to encourage the continued growth of fund supply. However, still more important is analyzing the mechanisms that make it viable to channel funds from institutional investors to the business sector, and in particular, the SME sector.
- 2.4 One way to help bridge the gap between the supply of funds and demand is to promote different mechanisms that will make it easier, more attractive and more

¹ SMEs in Peru are defined as enterprises with less than 50-100 workers and less than US\$1 million-US\$1.5 million in sales (PROMPYME), and up to 100 employees and US\$5 million in sales. The project will focus on SMEs as defined by the MIF.

secure for institutional investors to place funds. The venture capital industry is an instrument for business development that promotes viable businesses in various sectors, with varying levels of risk and life cycles. It also forces the enterprises that are candidates for investment to adopt rules of good corporate governance and modern management methods. Second, it “feeds” the financial market and the capital market while preparing enterprises to access long-term financing and even become publicly traded companies. Venture capital investment funds can be converted into intermediaries that can channel part of institutional investment funds, at appropriate costs, to the productive business sector.

Efforts to promote the capital market and venture capital investment funds

- 2.5 On 25 April 2001, the Ministry of the Economy and Finance (MEF) submitted, for public feedback, a working paper entitled “Access to Financing through the Stock Market” in order to obtain opinions and suggestions from experts and stakeholders on the guidelines for capital market legislative reform. The document analyzed in detail the development of the Peruvian capital market and proposed a series of measures aimed at: (i) adding new issuers to the stock market; (ii) increasing investor protection; (iii) raising the liquidity of securities; and (iv) strengthening the stock market’s institutional framework. The findings from the inquiry were published on 23 May 2001, launching a process of legislative and regulatory reform which continues to this day. Since 2002, CONASEV has been working on an amendment to the Investment Fund Regulations, slated to be promulgated in 2003, and also disclosed the respective draft for public feedback.
- 2.6 At the same time, PROCAPITALES launched a systematic effort to channel the concerns of the group of stakeholders that are part of the capital market – issuers, funds, investment banks, brokerage companies, etc. – to the public sector. This effort was initiated following the presentation of a document containing seven proposals for capital market development and a Corporate Governance Code, which gave rise to a document prepared jointly by such public institutions as CONASEV and the SBS, and private entities, such as the BVL and PROCAPITALES. One of the seven proposals placed before the MEF involved venture capital fund promotion, which the government endorsed, and in 2002, announced its intent to support the creation of these types of funds to spur the capitalization of the export industry.
- 2.7 In Peru, the venture capital investment industry is just emerging and has encountered the same problems the MIF has observed in other Latin American countries: (i) lack of information and the fledgling nature of the venture capital culture; (ii) paucity of institutions and professionals with expertise in this activity; (iii) lack of adequate and flexible instruments to stimulate seed capital investments and investments in start-up companies; (iv) lack of permanent channels to identify enterprises with potential and to systematically help them formulate and submit business plans for investors; (v) lack of processes structured to attract investors and

establish links between entrepreneurs and fund managers; (vi) lack of systems to undertake the evaluation of funds and fund managers with the degree of reliability and transparency required by investors; and (vii) lack of investor exit mechanisms.

2.8 The proposed project will benefit from the MIF's experiences in implementing the INOVAR program in Brazil, as well as in managing its venture capital fund portfolio. The MIF has learned that:

- (i) Supporting experience-sharing between fund managers regionally and nationally is very positive, because experience-sharing creates economies of scale.
- (ii) Disseminating knowledge of regulatory issues to the different market participants and increasing awareness of the importance of these issues and the need for the private sector to work with the public sector to create market-friendly legislation can lead to better legislation.
- (iii) The development of a methodology to evaluate the professional qualifications of fund managers and their business plans has inspired greater trust among international and regional private investors and pension funds, thereby enhancing the fund placement process.
- (iv) Cooperation among the investors, fund managers and the public sector is key to industry advancement. The MIF strategy must be based on the local strategy. Having in place a consortium of investors, such as in the case of Brazil, created economies of scale and proved a sound instrument for sharing risk as well as due diligence findings.
- (v) The funds can have a significant impact on the companies in the portfolio, in terms of enhancing their corporate governance and transparency practices.

III. PROJECT OBJECTIVES AND BASIC COMPONENTS

A. Objectives

3.1 The project objective is to help promote an enabling regulatory environment for capital market development and expansion and improvement of the financing opportunities for Peruvian SMEs. Capital market development in emerging markets covers a wide range of activities, which include institutional development and strengthening, the development of new financing instruments and mechanisms, and development and improvement of the legal and regulatory framework. The project will address these areas, with the goal of developing venture capital.

- 3.2 To attain the proposed objectives, the project will consist of the following three components: (i) support for a regulatory and legal framework conducive to capital market development; (ii) training and advisory services to enable SMEs to receive more favorable financing terms and, in particular, obtain direct investments through diversification of capital ownership; and (iii) expansion of risk investment fund management capacity.

B. Component I: Legislation and regulation (MIF: US\$170,500; local counterpart: US\$225,500)

- 3.3 This component will develop a systematic mechanism for interaction between the private and public sectors to draft rules and procedures conducive to market development and in line with the consulting processes which are now common practice in Peru. PROCAPITALES would coordinate the efforts of the various private sector players through a **regulatory unit**, and would prepare special studies on relevant issues being debated in government, utilizing communication and dissemination instruments, such as newsletters and a special window on the PROCAPITALES website. The regulatory unit would not only coordinate feedback on legislative initiatives and the necessary changes proposed in terms of the objectives of capital market promotion, but it would also help expand stakeholder involvement and conduct in-depth studies on the most important issues.

- 3.4 *Special studies.* Peruvian legislation on the development of capital markets, for example, the investment fund law, is currently being drafted and/or reviewed. The Congress of the Republic of Peru, as well as CONASEV, has asked PROCAPITALES for its opinion. It is estimated that between four and five studies a year will be needed during the three-year project execution period.

- 3.5 *Monthly Newsletter.* Through monthly newsletters, capital market development concepts will be disseminated, key legislative and regulatory agenda items will be summarized, and issues under debate will be given technical treatment. The newsletters will be distributed in printed form and posted on the PROCAPITALES website.

C. Component II: Training for small and medium enterprises (MIF: US\$610,500; local counterpart: US\$316,000)

- 3.6 The main objectives of this component are: (i) disseminate the capitalization culture and the concepts involved in the venture capital industry (venture capital web site and forums); (ii) select eligible enterprises to obtain investments by registering on the web site; (iii) train SMEs in strategic planning and corporate governance, directly and through training courses; and (iv) directly advise the SMEs selected to attend the forums and have attracted potential investors.

- 3.7 *Web site.* The Invest Program link will be posted on the PROCAPITALES web site, as a virtual meeting place for entrepreneurs, investors and others involved in venture capital activities. The web site will contain a variety of news concerning the Peruvian capital market, with an emphasis on venture capital-related information in Peru and abroad. In addition, the web site will also be used as a clearinghouse for information for investors and entrepreneurs.
- 3.8 *Venture capital forums.* The purpose of these forums is to bring together investors seeking opportunities and companies seeking partners to capitalize their businesses, and to increase the flow of available business for venture capital investments. The INOVAR experience, as well as that of Endeavor, another MIF-supported institution working with entrepreneurs and investors, demonstrates that these forums generate a positive experience on two fronts, by expediting financing and expanding networking.
- 3.9 Six events will be held during the three-year project execution period. It is estimated that about 50 companies will register on the web site for each event, of which about 10 will be selected for purposes of preparing them to be presented at the forums. An estimated 25 investors will participate in the forums each year. The events will be financed out of the registration fees paid by the entrepreneurs, the investors, the general public and the project sponsors.
- 3.10 *Training programs.* There will be two types of programs: (i) training through courses in which diplomas in strategic management and corporate governance will be earned, which will prepare the entrepreneurs for the investment forums, and (ii) customized advisory services for enterprises that spark investor interest at the forums.
- 3.11 A first stage in the selection of the enterprises will be through direct marketing. Through outreach, candidates will apply online. First the business plans will be prescreened. The preselected candidates will then be interviewed directly and screened a second time. This second preselection will serve to divide the candidates into: (i) those that will go directly to the venture capital forum, and (ii) those who will be offered training in strategic management and corporate governance before attending the venture capital forum. Of this second group, only the enterprises that submit a sustainable business plan at the end of that training program may attend the forum. In partnership with a prestigious business school in Peru, to be selected through competitive bidding in accordance with IDB rules, the project will offer the SME managers a degree in strategic planning and corporate governance.
- 3.12 The primary purpose of the degree will be to enable the entrepreneurs to prepare sustainable business plans and implement corporate governance practices likely to attract direct investments. The school selected to provide the courses for the degree will be selected based on the quality of its proposal and the tuition cost that it is willing to accept. The tuition for the first few years will be partially subsidized to

give the selected SMEs an initial incentive to participate and submit their business plans for evaluation. The first course would have to be offered at low cost so as to introduce it into the market and make it attractive to the preselected SMEs. At least four diplomas are expected to be earned, with an average of 10 participating enterprises in each of the courses.

- 3.13 Special consulting services will also be offered to enterprises that, having participated in the risk investment forum, have motivated an investor's firm interest. Therefore, such consulting services will begin after each forum has been organized.

D. Component III: Promotion of private venture capital investment (MIF: US\$170,500; local counterpart: US\$162,000)

- 3.14 Component III is designed to stimulate private venture capital investment, while supporting the development of the venture capital fund industry in Peru. This component will have two key activities: (i) develop local professional capacity in the Peruvian venture capital sector, promoting the use of best practices among fund managers (training program to strengthen fund management capacity); and (ii) creation of the Investment Facility, a consortium of investors aimed at bringing together private, public and institutional investors to jointly evaluate investment alternatives among existing and potential investment funds.

Training program for strengthening of fund management capacity

- 3.15 This training program will focus on all aspects of establishing and managing a fund, using the best market practices in the investment process, from the due diligence, investment, monitoring and exit stages, to training in corporate governance, financial transparency and compliance with social and environmental legislation.
- 3.16 The program, which will target current and future local fund managers, will consist of a special one-week course for managers, to be given six times during the project. Such training will make use of the best practices manual for new management companies being developed with the technical assistance of the MIF (TC 02-07-01-5).
- 3.17 The one-week course will be given by an organization that PROCAPITALES will select and approve in consultation with the MIF. There are few organizations in the world that have the knowledge and skills to give this course. PROCAPITALES has already contacted some of them. The project will finance practically all the expenses of the one-week course. The participants' tuition will cover the rest. The tuition will be subsidized for the first few years in order to provide the selected SMEs with an initial incentive to participate and submit their business plans for evaluation. Thereafter, the participants' tuition will cover the total cost of the course.

- 3.18 It is estimated that approximately 10 fund managers will participate in the program during the first year, and that this figure will rise in the following two years, as the conditions for venture capital activity in the country improve. The participants in the training program to strengthen management capacity will be chosen from enterprises operating in the sector and those that meet the investment criteria of the members of the Investment Facility.

Invest Program Investment Facility

- 3.19 The Investment Facility is a key aspect of the comprehensive approach to venture capital development in Peru. Its aim is for the institutions in the program to work together in the due diligence process to expedite the development of the venture capital industry and the creation in Peru of small funds catering to SMEs, with complete independence in decision-making on whether to invest in a fund.
- 3.20 The partners that PROCAPITALES will seek for the Investment Facility will be: (i) the four private pension funds (AFPs); (ii) mutual funds, and possibly the National Pension Office (ONP), which is in charge of managing a substantial portion of government pension funds; (iii) the Investment Development Agency (PROINVERSIÓN), the mission of which includes development of venture capital investment funds, that will act as liaison with the State; and (iv) the Andean Development Corporation (ADC). In addition, the MIF will join these partners, with its experience and knowledge of the international best practices in due diligence, evaluation and investment fund structuring.
- 3.21 Component III will train professionals in finance who are interested in fund management as the next step in their careers, fund managers who wish to enhance their professional skills through direct training; and investors, such as the pension funds and mutual funds, that will work jointly with the MIF and PROCAPITALES in the due diligence of potential investment funds, sharing the lessons learned and best practices compiled by the MIF in its eight years of working in the region. This will benefit the market, since such training will stimulate the venture capital sector, allowing for the development of a deeper and more formal venture capital industry, whose management will be entrusted to local qualified professionals. It will be beneficial for all kinds of potential investors, both national and international, that will develop a higher level of trust with respect to the professionalization of the country's fund managers.

IV. EXECUTING AGENCY AND PROJECT EXECUTION MECHANISMS, PROJECT STATUS AND DIRECT BENEFICIARIES

- 4.1 **Executing agency:** The executing institution will be the Asociación de Empresas Promotoras del Mercado de Capitales [Business Association for Capital Market Development] (PROCAPITALES), a private not-for-profit association, which

- includes the major players in the Peruvian market, such as underwriters, pension funds, investment fund managers (including venture funds), banks, insurance companies, brokerage firms, law firms and consulting firms. PROCAPITALES was founded in 2001, based on longstanding work among its members. Its mission is to develop the Peruvian capital market for purposes of contributing to productive investment and job creation. Among its principal goals is to improve financing terms for SMEs.
- 4.2 Despite its brief existence, PROCAPITALES has earned a privileged spot in Peru's economic landscape, since it has filled a void by bringing together enterprises and entities interested in market development.
 - 4.3 In 2002, PROCAPITALES published a Capital Market Manual in association with the seven law firms that sit on its board of directors. Moreover, in association with public and private institutions, it established a Corporate Governance Code for Peru. It also voices its opinion each week through its "Capital" seminar and has organized a group of 12 business breakfasts on market development issues.
 - 4.4 The highest governing body of PROCAPITALES is the meeting of the membership, followed by the board of directors, which is made up of the leading representatives of major companies in the field. The board, consisting mostly of senior-level executives in the respective enterprises, is supplemented by an advisory board consisting of well-known entrepreneurs.
 - 4.5 PROCAPITALES is currently in a position to attract major market players, in particular, pension funds and investment funds, as well as public sector institutions such as PROINVERSIÓN, to the Invest Program.
 - 4.6 **Execution mechanism:** Day-to-day project execution will be handled by a coordinating unit set up by PROCAPITALES, to be managed by the project director, who will be responsible for establishing and administering the program, and will act as liaison with the Bank for technical, operational, accounting and contractual issues.
 - 4.7 Component I will be executed by a team led by a regulatory expert consultant, who will report to the project director. The consultant in charge of this unit and those overseeing the other units will be selected by means of a private competition based on their professional background and experience in capital market-related fields of law and finance, with the participation of the project director, a representative of the PROCAPITALES board of directors and a representative appointed by the MIF. The consultant who will head the regulatory unit will be advised by the seven law firms that already sit on the PROCAPITALES board of directors, and will be assisted by a junior professional.

- 4.8 The activities for training and outreach under component II will be carried out by a team headed by an expert in SMEs and finance, who will be assisted by a junior professional and will be in charge of general coordination of: 1) web site development, for which a full-time professional will be employed and will act as webmaster; 2) training programs and liaison with the official in charge of the school selected for the course; and 3) organization of the forums, for which PROCAPITALES will provide assistance and expertise.
- 4.9 The Investment Facility will be coordinated by a specialist with experience in investment fund management, who will be assisted by a junior professional. The facility coordinator will act as secretary of the facility, which will be made up of the representatives of PROCAPITALES, the MIF and the institutions that agree to be part of the facility. As part of the strengthening of this facility, the project will finance the fees of two analysts who will help the specialist review the business and complete the necessary preliminary due diligence with respect to prospective beneficiary administrators.
- 4.10 **Reports:** Through the coordinating unit, PROCAPITALES will be responsible for supervising and preparing the semiannual project reports. Each progress report must document the activities carried out during the respective six-month period, emphasizing the project outcomes and impact. PROCAPITALES, the Country Office in Peru and the project team will agree on the content and structure of the progress report before it is submitted. In addition, the coordinating unit will prepare work plans and disbursement schedules for the following six-month period. The reports will be used for preparation of the project completion report and must be submitted to the Bank within 60 days following the end of the period. Within three months from the end of the project, the Bank will submit the project completion report to the MIF.
- 4.11 **Beneficiaries:** The beneficiaries of this project will be: (i) the enterprises that belong to PROCAPITALES and, in general, the players in the market environment who may benefit by having the project regulatory unit as a channel for their concerns; (ii) SMEs that receive training and advice; (iii) venture capital fund managers and angel investors who will benefit from a more streamlined and expeditious fund placement and investment process; and (iv) institutional investors and other qualified investors who, by participating in the venture capital forums, will learn better ways to evaluate and monitor their investments.
- 4.12 **Project status:** The project design, budget, activities and logical framework, including the respective benchmarks, and a memorandum of understanding between PROCAPITALES and other institutions interested in cofinancing the Invest Program were prepared jointly by PROCAPITALES and the IDB project team.

4.13 **Social and environmental impact and proposed measures:** The project team considers that this operation will not have any adverse social or environmental impact, since it concerns financial sector reform. On the contrary, the project is expected to have a positive impact on the dissemination of social and environmental issues, since:

- Such issues will be covered in the project's training component for current and future fund managers, pursuant to the environmental and social guidelines of the MIF (<http://www.iadb.org/mif/website/static/en/inver8a.asp>).
- In the training and consultation components, the direct beneficiaries of the project, the SMEs, will receive support in the form of information, training and technical assistance to address environmental concerns in their business plans, thus assuring environmental feasibility, including compliance with national environmental legislation and the applicable Bank policies.
- The PROCAPITALES database of companies applying for participation in the forums will include sector and origin fields to determine whether they concern indigenous groups and to which industrial sector they belong.
- The MIF will also emphasize the importance of these issues while conveying to other investors in Peru its own lessons learned on how to conduct due diligence, and on fund structuring and oversight.

V. COSTS AND FINANCING

5.1 The total estimated cost of the project is US\$1,981,800, to be financed by a MIF grant in the amount of US\$1,145,500 and a local counterpart contribution of US\$836,300. Table I shows a breakdown of the project budget according to the proposed activities.

Table I
Consolidated budget by component

Budget category (in US\$)	MIF	Local counterpart funding	Total
Component I: Legislation and Regulatory unit	170,500	225,500	396,000
Creation of unit			
Studies on special legal issues and newsletters	90,000	90,000	
	80,500	135,500	
Component II: Development of instruments for disseminating information, improving the quality of business flows, and training small and medium enterprises	610,500	316,000	926,500
a. Venture capital web site	50,000	84,000	
b. Venture capital forums	65,500	54,500	
c. Training programs	405,000	66,000	
d. Customized advisory services	90,000	90,000	
e. Equipment	0	21,500	
Component III: Strengthening fund management capacity in the region and institutional strengthening of an investment facility for the Invest Program	170,500	162,000	332,500
a. Fees	90,000	0	
b. Institutional strengthening	0	126,000	
c. Training program	80,500	30,500	
d. Equipment	0	5,500	
Executing unit and operating expenses	144,000	132,800	276,800
Evaluation and external audits	50,000	0	50,000
Total	1,145,500	836,300	1,981,800

5.2 The MIF contribution will be used to cofinance various project component activities, with emphasis on the enterprise training component, development of the web site, organization of the forums, and the evaluations and external audits. It will also finance a portion of the fees for the additional staff that will have to be hired for proper execution of the project, such as a project coordinator/director. The local counterpart institution (PROCAPITALES) will cofinance the remaining costs, along with all project operating costs, including fees for any new staff not covered by the MIF.

5.3 **Procurement of goods and services:** PROCAPITALES will be responsible for procuring the necessary goods and services for the project, in accordance with the

Bank's procurement guidelines, procedures and policies and the eligibility criteria established by the MIF for contracts.

- 5.4 **Execution and disbursement periods:** The project execution period will be 36 months from the date the agreement is signed, with a disbursement period of 42 months from that date. Once the conditions precedent for the first disbursement have been met, up to 10% of the MIF funds may be disbursed for purposes of setting up a revolving fund to facilitate project execution. The funds may be replenished upon submission of information justifying the use of the resources.
- 5.5 **Accounting and audits:** PROCAPITALES will be responsible for (a) establishing and maintaining accounting and financial controls, as well as adequate internal audits and a system to provide detailed documentation on the source and application of program funds, including: (i) identification of the amounts and sources of the funds; (ii) providing information on program expenditures, distinguishing those defrayed by MIF funds from those financed by other sources; and (iii) providing the details necessary to identify the goods procured and services contracted; (b) opening separate bank accounts to administer the MIF contribution and the local counterpart funds; (c) processing disbursement requests and the respective expense reports in accordance with Bank disbursement procedures; and (d) preparing and submitting to the Bank the program's final audited financial statements, as well as the semiannual reports on the revolving fund. The executing agency must submit the final audited financial statements to the Bank within 90 days from the date of the last disbursement. The Bank must previously accept the auditing firm, and the external auditing cost will be financed with the MIF funds.
- 5.6 **Sustainability:** For the **venture capital web site**, there will be: (a) a fee structure for establishing linkages between companies and investors; (b) corporate sponsorships; and (c) a possible option to privatize the web site. For the **venture capital forums**, revenue from companies, investors and sponsor enterprises is expected to cover all the costs by project completion. The forums organized by PROCAPITALES to date indicate that such projections are realistic. With respect to the **program for development of fund management capacity**, PROCAPITALES is confident that, over the three-year project execution period, the investors and fund managers will recognize the market, owing to the quality of the due diligence process and the management training provided. Thus, according to PROCAPITALES projections, this component will subsequently receive the financial support of its own beneficiaries, for example: (a) the fund managers, who will pay the full amount of the management training, which will continue to be given by consulting firms and teaching institutions familiar with the Invest project and the investment facility goals for improving the investment process, but no longer under the oversight of PROCAPITALES; and (b) institutional investors, who will pay for the information they receive on fund managers and are expected to share the expenses of comparative professional due diligence.

VI. RATIONALE AND PROJECT RISKS

A. Rationale

- 6.1 The purpose of the MIF is to assume measured risks that the market still cannot take on and to finance innovative projects with a demonstration effect that will provide information for the markets in order to promote eventual participation by other sources of financing. In recent years, the MIF has carried out a number of projects designed to promote venture capital development, in which a series of best practices have been identified that could be replicated in smaller countries with a still incipient industry, such as Peru.
- 6.2 This project will: (i) spread information on national and international venture capital activities; (ii) foster greater competition on the part of professionals engaged in evaluating new enterprises; (iii) improve the quality of business flows; (iv) promote more stringent professional standards and provide advisory services to Peruvian entrepreneurs; (v) develop an institutional system conducive to the establishment and growth of venture capital funds; (vi) make the private sector more attractive for purposes of enhancing investments for SMEs, emphasizing venture capital investments and other instruments such as subordinated debt; and (viii) expand financing opportunities for the enterprises by educating them on issues of major importance to investors, such as corporate governance, accounting transparency, environmental protection, and social and labor legislation. The proposal by PROCAPITALES, recommended by the last Peruvian Ministers of the Economy, has the distinction of being the product of an organization born out of the private initiative of citizens working in the private sector, seeking to collaborate with the public sector to improve financing terms for SMEs and the Peruvian market.

B. Risks

- 6.3 The project team believes that the Invest Program is a pioneering initiative for Peru, and compatible with the mandate of the MIF to act as a catalyst for private sector development in the region. By its nature, the program entails several risks that, in the team's opinion, are within the MIF margin of risk tolerance and can be mitigated by the lessons learned by the MIF in implementing other projects, which will be used to minimize the executing unit's learning curve. The main risks are:
- 6.4 The Peruvian capital market is still in its early stages, and the venture capital industry even more so. The country does not have many investment fund managers, which could prove insufficient to carry on the process. **Mitigating factor:** the project calls for the development of new managers, while helping existing managers to establish their funds. Having a structure may help in this process, as experience in Brazil has shown. The executing institution and its other partners, as

well as the project team, are confident that this comprehensive approach is what is needed to strengthen the venture capital industry in Peru.

- 6.5 The project is based on the assumption that changes in the regulatory framework for funds will be triggered by the push that the Invest initiative will generate in the market. But government and private sector initiatives have only been newly launched, and the Invest Program might not be capable of influencing CONASEV. **Mitigating factor:** PROCAPITALES is working actively to promote the Invest Program among CONASEV officials, some of whom have participated in forums organized by PROCAPITALES. The project team believes that PROCAPITALES, with the assistance of the MIF, will have the leadership capabilities necessary to bring together all the players in key areas of government who are in a position to change legislation not conducive to the development of venture capital investment.
- 6.6 The project assumes that the enterprises will be open to raising funds through venture capital, either directly through a private investor or through an investment fund. However, there may be some resistance, given the SME culture of family ownership and control, the heavy debt assumed by the enterprises followed by several years of economic recession, low accounting and auditing standards, and poor operation of the legal system, among other factors. **Mitigating factor:** the project will address these issues through various components, particularly the training courses and seminars. In addition, the project will be coordinated with other operations the MIF may carry out in the areas of accounting and auditing standards, corporate governance, and so on.

VII. MONITORING AND EVALUATION

- 7.1 Through the consulting services by outside experts hired by the Bank, the project will be subject to a mid-term evaluation 18 months after the first disbursement, and an evaluation of outcomes three months after project completion but prior to disbursement in full. The evaluations will be governed by the activity plan and by the indicators set forth in the logical framework shown in Annex I.
- 7.2 The mid-term evaluation will measure: (i) **with respect to the web site:** the quality of the information shown, the number of hits and the number of hits that generated online registrations; (ii) **with respect to the venture capital forums:** the number of companies preselected and the number of companies selected, the number of business plans reviewed and selected, the number of companies receiving customized advisory services and operation of the linkage generating new partnerships between entrepreneurs and investors; (iii) **with respect to the strengthening of fund management capacity:** number of current and potential fund managers that attended the management programs, and the number of business plans reviewed by the Investment Facility. The final project evaluation will

measure these same indicators over the three-year project execution period, as well as its sustainability after that period.

VIII. EXCEPTIONS TO POLICIES AND PROCEDURES

- 8.1 The project does not call for any exceptions to Bank policies.

IX. SPECIAL CONTRACTUAL CONDITIONS

- 9.1 Prior to the first disbursement, the executing institution will submit proof, to the Bank's satisfaction, that the coordinating unit has been set up and is operating.

LOGICAL FRAMEWORK
PERU: “INVEST PROGRAM”
(TC-02-07-01-4)

Goals	Indicators	Verification methods	Assumptions
Objective: Support an enabling regulatory framework for capital market development and increase and enhance financing for Peruvian SMEs.	In three years: The program will conduct studies on proposed changes in the capital market regulatory framework. It will serve at least 60 enterprises seeking investors through the various training and consulting advisory services provided and at least 15 investors seeking information on venture capital investment.	Final evaluation	
Purpose: Implement mechanisms to promote capital market development, emphasizing venture capital in Peru.	After project implementation: At least 6 proposals for strengthening the regulatory framework will have been formally submitted to the government. At least 30 SMEs will be in a position to obtain or will have obtained venture capital. The Investment Facility will issue three calls for proposals that may lead to the creation of investment funds in Peru	Mid-term and final evaluations	The legal and regulatory environment continues to improve. Pension funds show interest in investing in these instruments.
Components: <ol style="list-style-type: none"> 1. Development of instruments conducive to a regulatory environment that will benefit the capital market with an emphasis on venture capital. 2. Development of instruments for disseminating information, improving the quality of business 	Each year: <ul style="list-style-type: none"> • 4 studies on regulatory issues • 2 studies on proposed measures formally submitted to the government • 1 monthly newsletter a year (12) • 2 capital risk forums • 20 companies preselected per year • 10 companies receive customized advisory services each year 	Semiannual project reports Semiannual progress reports	

<p>flows and training small and medium enterprises.</p> <p>3. Development of fund management capacity; institutional strengthening of an Investment Facility is achieved.</p>	<ul style="list-style-type: none"> • 2 training programs per year • 10 fund managers trained • 4 investors selected to establish links with the Investment Facility of the Invest project • 5 current or future fund managers respond to calls for proposals for funds issued by the consortium of investors (starting with the second year, 5 per call) 		<p>Given the interest sparked in the country concerning venture capital issues and the opening of the capital market, there will be enough fund administrators currently or in training who will participate in the project</p>
<p>Activities:</p> <ul style="list-style-type: none"> ◆ Development of instruments conducive to a regulatory framework for capital market development, with an emphasis on venture capital ◆ Development of instruments for disseminating information, improving the quality of business flows and training small and medium enterprises ◆ Design of a special page on the PROCAPITALES web site ◆ Development of web site content ◆ Establishment and implementation of a program to assist enterprises selected to participate in venture capital forums and to 	<p>Studies and newsletters: US\$200,500 for three years</p> <p>Design of a special page for the Invest Program and improvements in the PROCAPITALES web site for three years: US\$80,000</p> <p>Web site content developed over a three-year period: US\$54,000</p> <p>Program to assist enterprises established and in operation for a three-year period: US\$471,000</p>	<p>Semiannual project reports</p> <p>Semiannual progress reports</p>	<p>There is Institutional cooperation between PROCAPITALES and its members, who agree to fully participate in the project.</p>

	provide customized advisory services for enterprises that attract the interest of investors			
1.1	Execution of operational logistics	Operational logistics for the three-year period: US\$303,300		
	Design of venture capital forums	Throughout the project: US\$136,000		
♦	Development of fund management capacity; institutional strengthening of the Investment Facility of the Invest Program is achieved.			
♦	Design and execution of the program to develop fund management capacity	Program designed during the first year and implemented throughout the project: US\$242,500	Semiannual project reports Semiannual progress reports	
♦	Methodology for selecting business plans and three invitations to submit business plans that may lead to the creation of venture capital investment funds, starting in the second year	Use of the methodology for the entire year, starting in the second year: US\$126,000		